BRIEF APPLICABLE TO THIS AND COMPANION CASE IN SUPPORT OF BOTH PETITIONS.

I. OPINIONS OF THE COURTS BELOW.

The opinions of the District Court appear in the Record at pages 337a, 349a and 362a. They have not yet been officially reported. The opinion of the Circuit Court of Appeals, a part of the Record, has not yet been officially reported.

The opinions of both Courts are attached hereto in appendix form for the convenience of this Court.

II. JURISDICTION.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code of 1911, as amended by the Act of February 13, 1925, Chap. 229, Sect. 1, 43 Stat. 936, 28 U. S. C. A., Sect. 347.

The judgment of the United States Circuit Court of Appeals for the Third Circuit, which Petitioner seeks to have reviewed, was filed on December 17, 1945.

III. STATEMENT OF THE CASE.

The essential facts on which this application rests are stated in the foregoing Petition for Writ of Certiorari. Insofar as may be required for a clear understanding of the several points of the ensuing argument, these facts will be supplemented by further references to the Record.

IV. SPECIFICATIONS OF ERROR.

The error which Petitioner intends to urge, if the Writ of Certiorari is granted, is that the Circuit Court of Appeals erred:

In failing to follow the finding of fact made by the District Court that the parties intended that the bond should run directly to Petitioner to secure its loans.

In holding, contrary to applicable decisions of the Supreme Court of Pennsylvania, that a bond given to secure the completion of buildings is conditioned upon the performance of the building agreement and not the construction of the buildings, even though the building agreement is referred to only in a recital.

In failing to follow the Pennsylvania rule that contracts of paid sureties will be construed strictly against them.

In failing to apply a consistent rule of interpretation as to the several agreements involved.

V. SUMMARY OF ARGUMENT.

1. The Circuit Court of Appeals disregarded the District Court's findings of fact which were supported by substantial evidence.

2. The construction placed upon the conditions of the bonds by the Circuit Court of Appeals is in conflict with applicable Pennsylvania decisions.

3. The rule, sustained by Pennsylvania decisions and decisions of this Court, that the contracts of paid sureties are to be construed strictly against them has not been followed by the Circuit Court of Appeals in these cases.

4. The decision of the Circuit Court of Appeals contains such a fundamental inconsistency that it constitutes a serious departure from the usual course of judicial procedure.

The Circuit Court of Appeals Disregarded the District Court's Findings of Fact Which Were Supported by Substantial Evidence.

The District Court adopted the stipulation of facts as part of its special findings of fact, and stated that "The statements of fact in the opinion may be taken as additional special findings, supplementing or modifying the facts as stipulated, and answering such requests as are not covered by the stipulation" (Appendix, p. 11a).

The District Court found as a fact from the circumstances involved that it was the intention of the parties that the bond was to run directly to the petitioner to secure its loan despite the fact that the transaction was in the form of a simultaneous assignment of the bond.

In its opinion, sur motion for new trial, the District Court summarized its original findings by making the following statement (Appendix, p. 12a).

> "In reaching its conclusions the court examined the entire transaction and *found that the bond was intended to run directly to the plaintiff to secure its loan,* the plaintiff being the real obligee, that the building operation had been undertaken by, or through the medium of, Equitable Bonded Mortgage Company and that Equitable, although on paper an obligee, was in reality and to the knowledge of the plaintiff in the position of a principal along with the building contractor (the nominal principal)." (Emphasis supplied.)

Under Rule 52(a) of the Federal Rules of Civil Procedure, it is stated that findings of fact shall not be set aside unless clearly erroneous.

Despite this clear injunction as to the effect to be given to findings of fact made by the trial court, the Circuit Court of Appeals for the Third Circuit saw fit to overrule the aforesaid finding of fact by the District Court

that the parties intended the petitioner to be a direct obligee. The Circuit Court of Appeals said (Appendix, p. 20a): "We do not see that the various facts urged by the Plaintiff to show that Provident was a direct obligee, prove the conclusion." At the time the Court made this statement the conclusion was an express finding of fact by the District Court and was no longer merely Petitioner's conclusion.

That there is ample evidence to support the District Court's finding as to the intention of the parties is apparent from the following evidentiary facts also found by the District Court and affirmed by the Circuit Court of Appeals (Appendix, pp. 18a-19a):

(1) The Respondent surety knew that the Petitioner and not the Equitable Bonded Mortgage Company was to be the ultimate recipient of the bonds.

(2) The assignment and consent to assignment, by Respondent surety, were executed before the bonds were even delivered to the nominal obligee, Equitable Bonded Mortgage Company, by Respondent surety.

(3) In each case the bond, assignment, consent to assignment, power of attorney authorizing the execution of the bond and a statement of Respondent's financial condition, were bound together as one instrument by Respondent surety prior to delivery to the nominal obligee, Equitable Bonded Mortgage Company.

(4) The whole transaction of delivery by Respondent surety to Equitable Bonded Mortgage Company and then to Petitioner was completed on the same day so that Equitable held the bonds only momentarily.

(5) The Petitioner required that construction bonds be furnished as collateral before it would loan its money to Equitable Bonded Mortgage Company.

In the light of these basic facts it is impossible to say that the ultimate finding of the District Court was "clearly erroneous"; and it is only on such a basis that the Circuit Court of Appeals had the power to disregard it.

Prior to the adoption of Rule 52 (a) this Court had already held that an appellate court cannot review the evidence for the purpose of drawing its own inference or conclusion therefrom at variance with the trial judge's finding of fact. Thus, in *McCaughn* v. *Real Estate L. T. & T. Co.*, 297 U. S. 606, this Court reversed the judgment of the Circuit Court of Appeals for the Third Circuit on the sole ground that the Circuit Court had failed to follow the District Court's finding that a gift had been made in contemplation of death. It was there said (p. 608):

> "The instant case is controlled by the established rules relating to appellate review in actions at law where a jury trial has been waived. R. S. 649, 700; 28 U. S. C. 773, 875. Where a general verdict is found by the trial court, it has the same effect as the verdict of a jury. The appellate court cannot pass upon the weight of evidence. * * * The ultimate question for the decision of the trial court was one of fact and its general verdict was conclusive. The Circuit Court of Appeals was without authority to weigh the evidence and to make its own findings."

This decision was recently cited with approval by this Court in *Allen* v. *Trust Company of Georgia, et al*, October Term, No. 289, decided January 28, 1946.

In *Tennessee Coal Company* v. *Muscoda Local*, 321 U. S. 590, decided subsequent to the adoption of Rule 52 (a), this Court recently considered the binding effect of the District Court's finding of fact with respect to the alleged existence of a custom in the coal mining business for the payment of wages during underground travel. It was there said by Mr. Justice Murphy (page 602):

> "We thus cannot say that the District Court's findings as to custom and contract are so clearly erroneous as to compel us to disregard them."

In *Commissioner of Internal Revenue* v. *Scottish American Investment Company, Ltd.*, 323 U. S. 119, this

Court, speaking again through Mr. Justice Murphy, made the following statement, which is particularly pertinent in the instant cases (page 124):

> "The Circuit Courts of Appeal have no power to change or add to those findings of fact or to reweigh the evidence. And when the Tax Court's factual inferences and conclusions are determinative of compliance with statutory requirements, the appellate courts are limited to a determination of whether they have any substantial basis in the evidence. *The judicial eye must not in the first instance rove about searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable.* It must be cast directly and primarily upon the evidence in support of those made by the Tax Court. If a substantial basis is lacking the appellate court may then indulge in making its own inferences and conclusions or it may remand the case to the Tax Court for further appropriate proceedings. But if such a basis is present the process of judicial review is at an end." (Emphasis supplied.)

In the instant cases the evidentiary facts were supplied by a stipulation and the testimony of one witness. As shown by the decision of this Court in the *Scottish American* case, *supra,* the conclusion of ultimate fact as to the intention of the parties by the District Court, is in itself a fact which cannot be disturbed unless clearly erroneous. The Circuit Court's misconception as to the conclusive nature of the District Court's findings based upon the undisputed evidentiary facts is apparent from the following statement in its opinion (App., p. 18a):

> "There were no conflicts of testimony to be resolved at the trial. Most of the facts were stipulated and the testimony of the one witness, A. G. Scattergood,

Vice-President of the plaintiff, was not disputed but relied on by the defendant. Our question becomes, therefore, what is the legal conclusion to be drawn from facts rather than what are the facts themselves."

It has been held by this Court that, insofar as the binding nature of the findings of fact are concerned, there is no difference between those which are based on stipulation and those which are based upon disputed testimony. Thus, in *Boehm* v. *Commissioner of Internal Revenue,* 90 L. ed. 96 (not yet reported officially), the following statement was made (p. 100):

> "The circumstance that the facts in a particular case may be stipulated or undisputed does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts. * * * If it is in accordance, [with law] it is immaterial that different inferences and conclusions might clearly be drawn from the undisputed facts."

The foregoing opinions by this Court in the *Scottish American* case and in the *Boehm* case were rendered in deciding appeals from the Tax Court. However, since in such cases the findings can be disregarded if they do not have "any substantial basis in the evidence", those decisions can be applied equally well under Rule 52 (a) where the finding is conclusive unless "clearly erroneous". In *National Mutual Casualty Co.* v. *Eisenhower,* 116 F. (2d) 891 (C. C. A. 10th, 1940) the Circuit Court of Appeals for the Tenth Circuit adopted the same reasoning under Rule 52 (a) as this Court applied in the *Scottish American* case. It was there said (p. 894):

> "Contradictions and conflicts of evidence are for the trier of the facts, whether it be court or jury, and where the evidence and the inferences fairly deducible

> from it are such that reasonable minds may honestly draw different conclusions from them, it has been held by this court that the question is not one of law, but of fact, to be determined by the trier of the facts."

It does not clearly appear from the opinion of the Circuit Court of Appeals whether that Court considered the question one of fact or of law. At one point, as has been seen, the Court treated the issue as a factual one, and at another point it considered only the wording of the assignments apart from the surrounding circumstances, thus implying a legal question solely. However, the Circuit Court of Appeals was not at liberty to nullify the effect of the Trial Court's finding by considering it in any light other than as a finding of fact.

It has long been held that the giving and execution of contemporaneous agreements, under circumstances which indicate that the parties intend to achieve a different result thereby than that apparent on the face of the instruments, makes the interpretation of the contemporaneous agreements a question of fact to be decided by the jury or by the judge, if sitting alone, as in this case.

The most revealing case on this subject is *Bogk* v. *Gassert,* 149 U. S. 17, decided by this Court in 1893. In that case two deeds, an agreement to reconvey, and a lease, all for the same land, were executed simultaneously by the parties. The suit was on the lease. The other contemporaneous agreements were put in evidence by the defendant along with other evidence as to the intention of the parties, asserting that the whole disclosed that the parties had intended a mortgage. This Court there said (page 29):

> "The case was evidently a proper one to go to the jury, who were left to determine the question whether the instruments were *intended* as a mortgage, and were instructed that, if they found them to be such, the plaintiffs could not recover." (Emphasis supplied.)

The foregoing rule also applies in Pennsylvania. Thus, in *Harper's Appeal,* 64 Pa. 315, it was held by the Pennsylvania Supreme Court that *the finding by the Trial Judge* that an absolute deed accompanied by a separate instrument, in which the grantee agreed to reconvey the property at the grantor's request within three years, was intended to have the effect of a mortgage, would not be disturbed on appeal without a conclusive showing to the contrary. It was there said (page 319):

> "Accepting the opinion of the court below as the report of a master upon the evidence, we see no plain mistake in the conclusion at which they arrived, that the agreement of March 19th 1858 was cotemporaneous with the deed of March 18th 1858, from Gubbings and wife to Harper. Without very clear and persuasive evidence that the sale was an absolute one, and the agreement to reconvey a subsequent, distinct and independent contract, we must treat the transaction as a mortgage. Such, undoubtedly, is the result of the authorities in this state: Colwell *v.* Woods, 3 Watts 188; Kerr *v.* Gillmore, 6 Id. 405; Jaques *v.* Weeks, 7 Id. 261; Brown *v.* Nickle, 6 Barr 390; Reitenbaugh *v.* Ludwick, 7 Casey 131; Wilson *v.* Shoenberger's ex'rs., Id. 295."

Likewise, in *Herman* v. *Pepper,* 311 Pa. 104, 166 Atl. 587, the Pennsylvania Supreme Court did not disturb *the finding of a Court of Equity* that an assignment of a partner's interest, absolute on its face but in fact given as security for a loan and accompanied by a separate agreement to reassign upon payment thereof, was in fact a pledge.

See also *Huston* v. *Regn,* 184 Pa. 419, 39 Atl. 208; and *McCollum* v. *Braddock Trust Company,* 330 Pa. 293, 198 Atl. 803.

The instant case is indistinguishable in principle from *Bogk* v. *Gassert, supra,* and the other cases cited above.[2] The bonds, assignments thereof and consents were executed contemporaneously. In fact, the assignments and consents were executed in advance of the time that the bonds became effective by delivery. Under such circumstances the intent of the parties was a fact to be determined by the trial court from all the circumstances, and, once having been determined, the Circuit Court of Appeals was not at liberty to set it aside unless clearly unsupported by evidence.

In *Biggs* v. *Mays,* 125 F. (2d) 693 (C. C. A. 8th, 1942), the Circuit Court of Appeals for the Eighth Circuit considered itself bound to follow Rule 52(a) in a case similar to the instant ones. In that case the question was whether the acts and words of a debtor constituted a promise to pay which had tolled the running of the Arkansas statute of limitations, a question of fact under the Arkansas law. The Court said (p. 699):

> "The court below found specifically that 'the facts do not justify any inference of a promise to pay the note as demanded by the claimant.' Under the law of Arkansas, as outlined above, the inference of a promise to pay *is one of fact,* and the finding of the court is binding unless clearly erroneous. Rule 52(a) of the Rules of Civil Procedure, 28 U. S. C. A. following section 723c."

In the instant case in arriving at its determination that the parties intended merely an ordinary assignment, the Circuit Court of Appeals for the Third Circuit ignored the following Federal Rules: (A) That an appellate court shall not draw its own conclusions and inferences from the evidence; (B) That findings based on

[2] The Circuit Court appears to have disregarded the principle of these cases in the mistaken belief that the decisions were based upon reliance upon superior skill, mistake or domination of one party by the other. That such is not the case is apparent from even a cursory reading of the opinions.

undisputed facts are as conclusive as those based on disputed ones; and (C) That a finding of fact shall not be set aside unless clearly erroneous.

Thus, we have here a situation in which the Circuit Court of Appeals has disregarded an express finding of fact by a District Court, supported by substantial evidence, which fact is not only relevant but is determinative of the issues involved in these cases. The writ should issue to correct this abuse of appellate review.

The Construction Placed Upon the Conditions of the Bonds by the Circuit Court of Appeals is in Conflict with Applicable Pennsylvania Decisions.

The Circuit Court of Appeals based its decision as to the proper interpretation to be placed upon the condition in the bond on the following statement of what it considers to be the law of Pennsylvania (Appendix, p. 22a):

> "If the Young case (Young *v.* American Bonding Company, 228 Pa. 373, 77 Atl. 623) is in point, we think it establishes the proposition that the words used in this type of bond which, in turn, contains a reference to a contract, makes performance of the surety's promise conditioned upon the non-performance of the main contract by the principal debtor."

Following this statement of its concept of the law of Pennsylvania, the Court held that the condition of the bond should be construed in the light of the terms of the contract mentioned in the recital. Hence the failure of the nominal obligee to perform under the contract constituted a defense for the surety.

This statement of the law is correct only if the reference to the contract appears in the *condition* of the bond. It is totally incorrect if the reference to the contract appears merely *in a recital* of the bond, as in these cases.

The recitals and the condition of each bond in the instant cases are as follows:[3]

> "WHEREAS, the Principal has entered into a written agreement dated the 15th day of October 1928, with the Equitable Bonded Mortgage Company for the erection and completion of twenty (20) dwellings on Southeast side of Wadsworth Avenue, between Anderson Street and Ardleigh Street, 22nd Ward, City of Philadelphia, in accordance with certain plans and specifications duly signed and approved by all parties interested; and
>
> "WHEREAS, the Equitable Bonded Mortgage Company has agreed to advance One Hundred Forty-two Thousand Dollars ($142,000.) for the purchase of, and to be secured by assignments of first mortgages on the above mentioned dwellings, and
>
> "WHEREAS, the Equitable Securities Corporation has agreed to advance Eighty-one Thousand Dollars ($81,000.00) for the purchase of, and to be secured by assignments of second mortgages on the above mentioned dwellings.
>
> "NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION IS SUCH, That if the buildings hereinabove mentioned shall be fully constructed and completed in accordance with the plans and specifications above referred to, and herein incorporated with like force and effect as if attached hereto, free and clear of mechanics' liens and municipal claims, within twelve (12) months from the date hereof, then this obligation to be void; or else to be and remain in full force and effect."

Certain things should be noted about this bond preliminarily. The first recital refers to two different things.

[3] The only differences between the bonds are the names of the builders, the amounts involved, and the location of the property.

The first is a contract between the builder and Equitable for the construction of the dwellings, and in which Equitable promised to pay the builder. The second is the plans and specifications according to which the houses were to be built. The condition is that the buildings shall be built—*not in accordance with the contract*, but—*in accordance with the plans and specifications*, which are expressly incorporated as if attached thereto.

It is, of course, obvious that the extent of the undertaking of the principal and surety in any bond is the condition of the bond. The prefacing of the condition by recitals is usually only for the purpose of setting forth the background for the condition.

In Pennsylvania the Courts look to the recitals of a bond to explain the condition thereof only in certain types of cases. Thus, if the condition is so indefinite as to be unenforceable, the Court will resort to recitals in order to clarify the condition: *United States* v. *Morrisdale Coal Co.*, 50 Fed. Supp. 138 (D. C. E. D., Pa., 1942); or if the basic contract, for the performance of which the bond is really given, is set forth in complete detail in a recital, the Court will interpret the condition in the light of the contract so set forth: *Nazareth F. & M. Co.* v. *Marshall Co.*, 258 Pa. 558, 102 Atl. 268.

It is readily apparent that the instant case does not fall within either of the foregoing categories. Thus, the recital merely mentions the existence of the builder's agreement and there is no attempt to set forth in detail any of the terms of that agreement. Nor can it be said by any stretch of the imagination that the condition of the bond is so indefinite as to need explanation or amplification by the recitals in the bond.

There is one last exception to the general rule that the condition of the bond alone measures the liability of the parties thereto. That exception is the one which the Circuit Court of Appeals in these cases has mistakenly applied as a general rule. There are two cases which

give rise to this exception. One is the *Young* case, cited by the Circuit Court, and the other is *Dunbar* v. *Fleisher,* 137 Pa. 85, 20 Atl. 520. To show the genesis of this exception, and thereby clarify the decision in the *Young* case, the holding of the Pennsylvania Supreme Court in *Dunbar* v. *Fleisher* will be considered first. In that case the defendant, Fleisher, was surety on a bond for the faithful performance by two men, Harper and Famous, of certain masonry work *"as per contract"* between those two men and the plaintiff.[4] The said Harper and Famous did not perform the masonry work and this action was against the defendant on his surety bond. The defense was that payments required to have been made to Harper and Famous by the plaintiff had not been made and that therefore the defendant was relieved of his obligation, the same defense which the defendant has raised in this case. It was there held by the Supreme Court of Pennsylvania, in affirming judgment for the defendant, that the defense of non-payment under the terms of the principal contract was properly raised since *the condition* of the bond expressly referred to that contract.

Young v. *American Bonding Company, supra,* is the same as the *Dunbar* case. In the *Young* case the bond in suit was also a construction bond. It recited the existence of the contract under which the construction improvements were to be made, and was conditioned upon the faithful completion of those improvements *"as provided in said agreement".*[5] The Supreme Court of Pennsyl-

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[4] "Whereas, J. R. Dunbar has this day given to Jesse Harper and John Famous an order on the county commissioners for $62, or the amount that shall be due them for mason work at the completion of the bridge in Penn township, Perry county, Pennsylvania. Now, in consideration of $1 to me in hand paid, I hereby become security for said Harper and Famous for the faithful performance of said mason work to said bridge, *as per contract* with said J. R. Dunbar." (Emphasis supplied.)

[5] "Now therefore the condition of this obligation is such that if the said principals shall well and faithfully construct and complete said improvements of the value of Three Hundred and Fifty Thousand Dollars ($350,000) upon said property, *as provided in said agreement,* on or before the 31st day of December, 1906, then this obligation to be null and void; otherwise it shall remain in full force and effect." (Emphasis supplied.)

vania again held, and properly so, that the undertaking of the surety, as shown by the condition of the bond, was subject to the terms of the agreement since the condition expressly referred to that agreement.

The reason behind the decisions in the *Young* case and the *Dunbar* case is plain. The condition of the bond was that certain things be done in accordance with a contract, and therefore the contract became a part of the condition. It is merely a specific application of an elementary rule of interpretation.

In the instant cases, unlike the *Young* case and the *Dunbar* case, however, *the condition* of the bond makes no reference to the agreement between the builder and the promoter. It is only in the recital that the contract appears at all. To hold, as the Circuit Court did in these cases, is to build one exception to the general rule on top of another exception, that is, to construe a clear condition needing no explanation in the light of a contract mentioned only in a recital and not even referred to in the condition.

The strained nature of this interpretation is particularly apparent from the fact the parties showed clearly that they knew how to incorporate by reference. The condition is that the houses shall be built by either the builder named in the bond or by the surety "in accordance with *the plans and specifications* above referred to, and herein incorporated with like force and effect as if attached hereto". By applying the common-sense rule of *expressio unius est exclusio alterius* it is evident that the parties intended that the contract should *not* be a part of the condition.

The decision of the Pennsylvania Supreme Court in the case of *Purdy* v. *Massey,* 306 Pa. 288, 159 Atl. 545, states the law clearly applicable here. Due to the fact that certain phases of that case are so similar to the ones in the instant case, it is felt that the following detailed

discussion is merited.[6] In that case the owner of land had entered into a written agreement with the builder for the construction of a garage in accordance with detailed plans and specifications. The plaintiff agreed to subordinate her first mortgage on the land to a new mortgage, the proceeds of which were to be used to finance the construction. In return for subordinating her first mortgage, the plaintiff asked for, and received, a surety bond which, after reciting the existence of the construction agreement between the builder and owner, contained the condition that provided the builder should "complete the buildings mentioned free and clear of mechanics' liens or claims, then this obligation shall be void; otherwise to be and remain in full force and effect". The garage was never built and this suit was upon the bond against the builder and the surety. After judgment for the plaintiff in the Trial Court, the defendant surety appealed, and one of its assignments of error was that the Trial Court had refused to charge that there was no default on the part of the builder since the builder had never received the money payments required by the contract, the same defense as in the present cases. This assignment of error was overruled by the Pennsylvania Supreme Court and the judgment of the Court below was affirmed. The Court held that the undertaking by the defendant surety was an absolute one for the construction of the garage, and that the terms of the contract did not enter into the interpretation of the bond condition. It said:

> "The covenants in a bond 'should be construed to mean what the parties intended in so far as that intention can be ascertained by the words used': Equitable Trust Co. *v.* National Surety Co., *supra.* If, however, the language is not free from doubt, then the circumstances surrounding the making of the bond, and particularly the purpose for which it was given,

[6] The information appearing in this discussion which does not also appear in the printed report of the case, was obtained from the original record.

should be taken into account: March *v.* Allabough, 103 Pa. 335; Ambridge *v.* P. & B. St. Ry. Co., 234 Pa. 157. In this case such considerations lead to but one conclusion—*that this bond was an absolute undertaking to erect and complete the building.*

"This bond is to be construed most strictly in favor of the plaintiff. The obligor, Indemnity Insurance Company of North America, is a paid surety engaged in the business of furnishing bonds for profit; we have frequently held that in cases of corporate sureties, the bond is to be strictly construed in favor of the obligee: Young *v.* American Bonding Co., 228 Pa. 373; South Philadelphia State Bank *v.* National Surety Co., 288 Pa. 300, and cases there cited.

"*The condition of the bond is performance of a specific thing—completion of the building provided for in plans and specifications made a part of the bond—and the only alternative for performance is the bond itself.* It is obvious, being clearly expressed by the words of the bond and the circumstances surrounding the transaction, that the intent of all concerned was to give plaintiff in lieu of her first mortgage the enhanced value of the real estate by the addition of the building, or failing that, its equivalent in money—not to exceed the face value of the bond." (Emphasis supplied.)

The decision in the *Purdy* case is clearly in point here. The recital mentioned the builder's contract, the condition did not, and the court held that the bond was an absolute undertaking that the structure be built. Furthermore, it can be said with equal force in this case that the purpose of the bond was to give Petitioner "the enhanced value of the real estate by the addition of the building, or failing that, its equivalent in money."

It will be noticed from the decision of the Court in the *Purdy* case that if the language of the bond is not free from doubt "then the circumstances surrounding the making of the bond, and particularly the purpose for which it was given, should be taken into account". The Petitioner believes that the language is clear and unambiguous, but since the Circuit Court of Appeals did not, or otherwise it would not have resorted to the contract, it should have followed the findings of fact by the District Court. That Court considered the case as one requiring an examination of the surrounding circumstances and found as follows (App., p. 8a):

> "So considered I find that the bond in this case was an absolute undertaking by the defendant directly to the plaintiff that the houses would be completed according to plans and specifications identified by reference to the operation agreement, that it was intended solely to secure the plaintiff's loan and was not intended to and did not guarantee full performance of the operation agreement, that it was not intended to and did not confer any rights (except contingently on full payment to the plaintiff) upon Equitable or its subsidiary, that the plaintiff was the real obligee and that no default on the part of the nominal obligees would affect the plaintiff's rights."

Since the Circuit Court of Appeals believed that the language was ambiguous, it was no more at liberty to disregard the District Court's finding in this particular than it was as to the parties' intent in making the "assignment" (see *supra*, pp. 13-16).

The discretionary power of this Court may be invoked to grant a writ of certiorari when a Circuit Court of Appeals has made an error in interpreting an important question of local law. The importance to the Petitioner of the error in these cases can be seen from the fact that

the judgments in these companion cases total almost a million dollars. The importance of the decision to those dealing with surety bonds in Pennsylvania can also be seen from the fact that the door has been opened now to interpretation in the light of any and all recitals unless it is expressly stated that they are *not* a part of the condition. If that is to be the law, when heretofore only the contrary was true, a great deal of the collateral held by financial institutions in Pennsylvania has decreased in value over night. This Court should exercise its power to review these cases and set at rest the doubts created by the Circuit Court of Appeals' decision.

The Rule, Sustained by Pennsylvania Decisions and Decisions of This Court, that the Contracts of Paid Sureties Are to Be Construed Strictly Against Them, Has Not Been Followed by the Circuit Court of Appeals in These Cases.

It is a settled rule in Pennsylvania, as it is throughout this country generally, that the contract of a paid surety will be construed most strongly against the surety and that all doubts and technicalities arising in said undertakings will be resolved in favor of the obligee. A typical statement of this rule appears in *Mechanics Trust Co.* v. *Fidelity & Casualty Co.*, 304 Pa. 526, 156 Atl. 146, where it was said (p. 533):

> "We have frequently said that the trend of modern decisions, federal and state, has been to distinguish between individual and corporate suretyship, where the surety has undertaken, for money, the contract of suretyship which it is its business to sell; in such cases, the contract should be construed most strictly in favor of the obligee: South Philadelphia State Bank *v.* National Surety Co., 288 Pa. 300, 305-6, and cases there cited."

See also, *Monongahela Street Railway* v. *Philadelphia Co.,* 350 Pa. 603, 617, 39 A. (2nd) 909; *Fiumara* v. *American Surety Co.,* 346 Pa. 584, 595, 31 A. (2nd) 283; *Hess* v. *Merion Title & Trust Co.,* 317 Pa. 501, 505, 177 Atl. 53; *Sokoloff* v. *Fidelity & Casualty Co. of N. Y.,* 288 Pa. 211, 215, 135 Atl. 746.

In spite of this well established rule of construction, the Circuit Court of Appeals construed the bonds in suit in favor of the paid surety. In fact, it may well be said that the Court treated the Respondent as though it were a volunteer surety, a favorite of the law.

The Petitioner does not believe that the language of the bond need be strained to be construed against the Respondent Surety in order to hold that the condition of the bond is absolute for the building of the houses. It is submitted that the mere reading of the bond itself, without construing it expressly in favor of one party or the other, leads inevitably to that conclusion. On the other hand, however, the Petitioner is aggrieved by the obvious fact that the condition of the bond was construed against it, an assured, and in favor of the Respondent, a paid surety.

It was the business of the Respondent to insure the undertakings of other persons. It is experienced and, presumably, normally efficient in this business. If the Respondent had intended originally that its obligation to construct the dwellings should be dependent upon the performance of the building contract between the builder and the promoter, it could have protected itself by inserting a reference to that contract in the condition of the bond, or by merely guaranteeing the performance of that contract. The surety disclosed in the condition as written the fact that it knew how to incorporate extraneous documents into the condition of the bond, for it did so as to the plans and specifications for the dwellings which, like the contract, were referred to in the recital. In the face of this demonstration of skill in draftsmanship, one must

be most solicitous of the welfare of the surety to conclude that the contract was also incorporated in the condition.

Only by distorting the language of the instrument is one able to reach the conclusion, achieved without apparent difficulty by the Circuit Court of Appeals, that the Respondent Surety had premised the performance of its undertaking upon the accomplishment by the promoter of all the many acts required of it in its contract with the builder. If clear and unambiguous language is to be perverted by "interpretation", let that be done for the benefit of the innocent lender, and not for the gain of the paid surety.

The ultimate effect of favoring the surety in this instance is stated by the District Court (App., p. 7a):

> "To sustain it (the Respondent's contention) would result in giving to Equitable, which received the plaintiff's money and which was one of two parties ultimately to benefit by it, a status which would allow it to dissipate the money or appropriate it to its own purposes, and by doing so, at one and the same time prevent completion of the houses and destroy the plaintiff's right to realize upon its security. To state that proposition, it seems to me, is to answer it."

The Circuit Court of Appeals, by its decision in this case, manifestly has accorded to Respondent Surety a position completely at variance with the one to which it is entitled under the general rule. The Court has therefore misapplied, and not merely failed to apply, an important rule of Pennsylvania law.

The principle that contracts of paid sureties will be construed against them was called to the attention of the Circuit Court of Appeals by counsel for Petitioner by citing the case of *Baglin* v. *Title Guaranty & Surety Co.*, 166 Fed. 356; affirmed 178 Fed. 682 (C. C. A. 3rd, 1909). This authority was summarily disposed of by the Circuit

Court of Appeals in the following footnote to its opinion (App., p. 16a):

> "The decision referred to by appellee as presenting a case (Baglin *v.* Title Guaranty Surety Co., 166 Fed. 356, affirmed 178 Fed. 682 (C. C. A. 3, 1909)) 'so nearly identical' was decided long before Erie R. Co. *v.* Tompkins was ever dreamed of. A Federal Court decision upon a question of state law settled upon principles of 'general commercial law' is no precedent now."

A careful reading of the opinions in the *Baglin* case would clearly show that these opinions state not only the general law applicable to the defense of a paid surety, but record the then and present law of Pennsylvania—all contrary to the different and new law now made by the decision of the Circuit Court of Appeals herein complained of. The following quotations from the *Baglin* case show how erroneous the footnote is:

By Judge McPherson (166 Fed. 363):

> "Nor is there any reason to be astute in looking about for flaws that may invalidate the transaction. The defendant is not entitled to the tender consideration that is accorded to an individual surety who is a mere volunteer. Surety companies are not to be so described; they are insurers, paid for their services, bound by contracts which are usually carefully drawn by themselves, and, as a general rule, satisfactorily secured by counter indemnity. They perform a most useful, and indeed, according to modern custom, an indispensable, function in the business and legal world, but they differ so much from an individual surety of the ordinary type as to render inapplicable some of the reasons that have led the courts to guard the rights of the individual surety with jealous care."

By the Circuit Court of Appeals, affirming (178 Fed. 687):

> "• • • The bond sued upon is not an indemnity bond. Defendant is bound, as surety or guarantor, to the plaintiff, as obligee in the bond, and, in the words of the trial judge, 'the fact remains that the guarantee in question was given and paid for; that it warranted the performance of a lawful act, and that such act has not been performed,' and by its nonperformance, defendant's liability is fixed."

Petitioner respectfully submits that if a new rule of law is to be established now by judicial fiat, to relieve a paid surety from its contract obligations, it should be established by a decision of this Court, after full consideration, and not by the Circuit Court of Appeals for the Third Circuit.

The Decision of the Circuit Court of Appeals Contains Such a Fundamental Inconsistency That it Constitutes a Serious Departure From the Usual Course of Judicial Procedure.

As has been seen, the Circuit Court of Appeals judged this case from two aspects. First, it considered whether the transaction was an assignment of the bond which would permit the Respondent Surety to raise a defense against the Petitioner which it would have had against the nominal obligee, or whether it was a direct obligation to Petitioner. Secondly, it considered whether the bond was an absolute undertaking, or whether the condition of the bond was itself conditioned upon the performance of the building contract. In the first instance, the Court held that the transaction was an ordinary assignment; and, in the second instance, it determined that the condition of the bond was modified by the terms of the building contract.

In deciding that the Petitioner was merely an assignee of the bond, the Court said that the language used in the instrument was not ambiguous and that therefore it would not consider the surrounding circumstances in determining the intent of the parties. However, in construing the condition of the bond, the language of which is certainly as clear and definite as that of the assignment, the Court read into it the terms of the main contract between the nominal Obligee and the Obligor Builder, which contract was not even referred to in the condition.

Despite the fact that the Circuit Court of Appeals stated in its opinion that "the rule that contracts mean what they clearly say applies to both contracting parties", the Court nevertheless applied a rule of strict construction to the benefit of the paid surety in one phase of the case; and, in the other phase of the case, in which the rule of strict construction should have been applied, it chose to adopt a liberal and strained construction, also to the benefit of Respondent Surety.

If the Circuit Court of Appeals had consistently applied the first rule which it employed, namely, that only the exact language of the contract will be considered, it would necessarily have had to find that the condition of the bond was absolute for the construction of the dwellings in any event. Nothing could be more certain or unambiguous than the covenant in the bond that "if the buildings hereinabove mentioned shall be fully constructed and completed * * * free and clear of mechanics' liens and municipal claims, within twelve (12) months from the date hereof, then this obligation to be void; or else to be and remain in full force and effect".

On the other hand, if it had applied throughout the second rule which it adopted, namely, that matters extraneous to the agreement may be considered in interpretation, it would have followed the finding of fact by the District Court that the surrounding circumstances showed the parties intended an absolute undertaking by the Builder and Respondent Surety directly to Petitioner.

It is disturbing to find that the Circuit Court of Appeals adopted this inconsistent attitude in the face of the fundamental rule that the contracts of paid sureties shall be construed strictly against them.

The rationalization by the Circuit Court of Appeals of this obvious inconsistency to the benefit of the Respondent Surety might possibly be said to be based on a misconstruction of the decision of the Pennsylvania Supreme Court in *Young* v. *American Bonding Company, supra,* and a further misconstruction of the general rule as to the proper mode of interpretation of contemporaneous instruments. However, two wrongs do not make one right. Either the Court should have applied the rule of strict construction throughout, and in doing so found that the condition of the bond was absolute; or it should have held that the circumstances of the transaction were relevant and affirmed the judgment of the District Court on its findings of fact.

The fundamentally inconsistent reasoning applied by the Circuit Court of Appeals in these cases, to the benefit of the Respondent Surety and to the great pecuniary harm of the Petitioner, who advanced money in reliance upon Respondent Surety's promise, is so great that it constitutes a departure from the usual course of judicial procedure. If "the rule that contracts mean what they clearly say applies to *both* contracting parties", then this Court should grant a writ of certiorari so that that rule may be enforced.

CONCLUSION.

It is submitted that the Circuit Court of Appeals, by its decision in these cases, has violated Rule 52(a) of the Federal Rules of Civil Procedure and the decisions of this Court interpreting that Rule.

In addition to having rendered a decision in conflict with the decisions of this Court, the Circuit Court of

APPENDIX.

OPINION.

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

No. 15270. March Term, 1930.

Provident Trust Company of Philadelphia

v.

Metropolitan Casualty Insurance Company of New York.

(Filed June 8, 1944.)

Before (s) KIRKPATRICK, *J.*

This is one of two civil actions which were tried together to the Court without a jury. The two actions are against a surety company and are based upon three bonds of a type commonly known as completion bonds, given in connection with three building operations, referred to respectively as the Furman, Roehm and Storck operations, those being the names of the three builders. The bonds are essentially alike and the two cases present the same questions of law, the only difference being that in the first case (Furman and Roehm bonds) the plaintiff sues in its individual capacity and in the second case (Storck bond) as trustee. As a matter of convenience the Furman operation will be considered, it being understood that the discussion, except as noted, applies equally to the other two operations.

The operation was undertaken by, or through the medium of, a corporation named Equitable Bonded Mortgage Company which, with a wholly owned subsidiary, Equitable Securities Corporation, was in the business of financing such operations, either by purchasing mortgages on the lots upon which houses were to be built or by lending money upon the security of such mortgages. The financing in this case was accomplished by means of the following (apparently) successive steps:

(a) A contract between the builder and Equitable, called an "operation agreement" which provided, among other things, that mortgages would be placed upon 20 of the lots, that a house would be constructed upon each according to agreed plans and specifications, that the mortgages would be transferred to Equitable and that Equitable would supply the money to the builder as the work proceeded. (b) The creation of the mortgages by the builders and their delivery to Equitable. (c) A bond given by the builder as principal, with the defendant as surety, to Equitable and its subsidiary for the completion of the houses. (d) Tender by Equitable to the plaintiff of its note in the amount of $112,000, the 20 mortgages, assigned to the plaintiff, and the defendant's surety bond assigned by Equitable to the plaintiff, accompanied by the defendant's written consent to the assignment. (e) The advance by the plaintiff to Equitable of $112,000.

The operation agreement, the mortgages and the assignments of them to Equitable and by Equitable to the plaintiff, the defendant's bond, its assignment by Equitable to the plaintiff, and the defendant's consent thereto all bear the date of October 15, 1928, and, as a matter of fact, the whole transaction was consummated on that day, except that the plaintiff advanced the money from time to time as required. Before (Stipulation Par. 3) the defendant's bond was delivered to Equitable, an assignment of it by Equitable to the plaintiff had been executed and the defendant had placed its written consent upon the instrument of assignment. The bond and assignment, with a statement of the defendant's financial condition and a power of attorney authorizing the execution of the bond, were bound together and backed by a single office backer of the defendant. In that form they were presented to the plaintiff together with the mortgages and Equitable's note.

It is undisputed that the houses were never completed (in fact, they were scarcely begun) that Equitable's note is unpaid and worthless, that the plaintiff realized the sum

of $150 from the sale of the mortgages, that no recovery can be had from the builder, that had the houses been completed the plaintiff would have been amply protected and that unless the plaintiff can hold the defendant upon its bond it will lose most of its loan.

The bond names Equitable and its subsidiary as the obligees. It recites and identifies the operation agreement between the builder and Equitable and the agreements of Equitable and its subsidiary to advance money for the work to be secured by assignment of first and second mortgages on the houses. The condition is as follows, "That if the buildings hereinabove mentioned shall be fully constructed and completed in accordance with the plans and specifications above referred to, and herein incorporated with like force and effect as if attached hereto, free and clear if (sic) mechanics' liens and municipal claims, within twelve (12) months from the date hereof, then this obligation to be void; or else to be and remain in full force and effect."

The surety's defenses are:

1. That the builder having been excused from performance by Equitable's default in failing to advance money for the buildings as it had agreed to do in the operation agreement and the principal therefore not being liable, the surety could not be held by Equitable, and hence cannot be held by the plaintiff, which, the defendant says, is nothing more than an assignee of a defaulting obligee, with rights no broader than those of its assignor. Note. It is an undisputed fact that Equitable never advanced any money to the builder for the construction of the houses, and it may be accepted as a fact that that was the reason the houses were not built and that, as between himself and Equitable, the builder would have been excused from performing by the failure of Equitable to advance the money or, as the defendant describes it, failure of consideration.

2. That Equitable and its subsidiary are joint obligees, and that default on the part of the subsidiary, the second

mortgage, which did not join in the assignment of the bond to the plaintiff is fatal to the rights of Equitable or any assignee of Equitable, regardless of any rights which the plaintiff might still have, had Equitable been the only obligee.

3. That the plaintiff lost its rights against the surety, because

(a) Its sale of the mortgage after default carried the right to recover on the surety bond, which, the defendant says, was given as security for the mortgages only, and so the sale divested the plaintiff of all further interest in the surety bond.

(b) The subsequent satisfaction of the mortgages paid the debt and released the surety.

(c) The renewal, before default, by the plaintiff of Equitable's six months note for a further period of six months, was an extension of credit which released the surety.

4. That the plaintiff has failed to prove damages.

5. That the plaintiff has lost its rights by abandonment and delay in prosecution.

At the center of the entire controversy, decisive of the issue raised by the first two defenses and directly affecting the third and fourth, lies the question whether this is a bond for the faithful performance of a contract (the operation agreement) or a bond for the completion of houses. If the former, the position taken by the surety in its first two defenses has, at least, technical merit. If the latter, it has none at all.

The defendant relies upon Young *v.* American Bonding Co., 228 Pa. 373. In that case the condition of a bond in terms similar to but not identical with those in the present case was construed in connection with the recitals (which referred to portions of a contract roughly corre-

sponding to the present operation agreement) to cover the faithful performance of the entire contract, including details of financing, and the Court held that a material alteration to the detriment of the surety in some of the financing provisions released the surety.

I do not think that Young *v.* Bonding Co. rules the present case.

The difference in the wording of the conditions of the two bonds may be noted. It is slight but not entirely without significance. In the Young case the condition was, "if the said principals shall well and faithfully construct and complete . . .." In the present case the condition is, "That if the buildings hereinabove mentioned shall be fully constructed and completed . . .."

But regardless of similarities or dissimilarities in the two bonds, the evidence shows that the transactions of the Young case and the present case, of which the bonds in the two cases formed part, were fundamentally entirely different, a fact which compels a different construction of the condition of this bond.

There is no doubt about the principle of the Young case that the recitals of a bond may properly be referred to in order to ascertain the scope of the condition. But the recitals are not always conclusive, and the Young case does not decide that they are. In construing the condition of a bond, the circumstances, including the nature of the transaction as a part of which it was given, are to be taken into account. If, when the entire transaction is considered it appears indisputably that the intention was to give the surety's absolute undertaking, disassociated from other contract obligations, that certain buildings would be completed then the condition must be so construed, though the recitals contain a reference to the other provisions of the contract. This, I think, is what appears in the present case.

I have described the form in which the transaction was cast. The substance of it was this:

Equitable and the builder, for their mutual profit, proposed to engage in a venture, consisting of the building of houses, for which money, in the amount of $112,000, was needed. It was found to be necessary, convenient or desirable to borrow from the plaintiff, which was willing to lend the money on the security of the land if, and only if, it could be assured by a corporate surety bond that houses would be built upon the land and completed in accordance with the plans. The plaintiff had no interest whatever in who got the money or how it was used. If the bond was adequate and the obligation honored, nothing the parties to the operation agreement might do or fail to do would affect the security of the loan. The defendant executed its bond with the condition that the houses would be built. The defendant knew the money for the operation was coming from the plaintiff and that the bond was going to be offered as security. And it must have known, from the dates which the documents bore and the fact that its bonds was delivered to Equitable already assigned to the plaintiff, if from nothing else, that the transaction was not and was never intended to be a series of distinct steps but was simply a borrowing from the plaintiff upon collateral which included the bond. With this knowledge it accepted the premium and delivered the bond, upon the faith of which, primarily, the plaintiff advanced the money.

Only on paper was Equitable ever an obligee. It never took anything but a remote and contingent interest in the bond, an interest which could attach only after the plaintiff had been paid in full, and, as a matter of fact, that never happened. Its position, if it be necessary to assign it a position, was in reality that of principal along with the builder. The subsidiary was Equitable's creature, and the legal fiction of a separate corporate existence for it cannot change the realities of the situation. It would be idle to pretend that Equitable's acts were not the acts of the subsidiary and that, so far as the plaintiff in this transaction was affected, the two corporations were not one and the

same. (Defendant's fifth request for finding of fact, affirmed by the Court.)

The defendant's position is a stand upon the technical aspect of the transaction. To sustain it would result in giving to Equitable, which received the plaintiff's money and which was one of two parties ultimately to benefit by it, a status which would allow it to dissipate the money or appropriate it to its own purposes, and by so doing, at one and the same time prevent completion of the houses and destroy the plaintiff's right to realize upon its security. To state that proposition, it seems to me, is to answer it.

The defendant contends that the parol evidence rule forbids the Court to look through the paper screen and view the transaction as it really was. This, however, is not so. If the language is not free from doubt (and it is certainly not free from doubt in the present case) then the circumstances surrounding the making of the bond and particularly the purpose for which it was given, should be taken into account. Purdy v. Massey, 306 Pa. 288, 293. But even where language is plain and unambiguous, there are many situations in which circumstances may be resorted to to show that a transaction is, in reality, something entirely different from what it appears to be. For example, a clause expressly stipulating for liquidated damages may be shown to be a penalty. A transfer, absolute on its face, may be shown to have been given for security only. A document purporting to be a bailment lease will not prevent the Court from holding the transaction a conditional sale if such it was in fact.

In Purdy v. Massey, supra, the Court considered the entire transaction of which the bond was a part and, holding that the wording of the condition was not free from doubt, said, "In this case such considerations (the circumstances surrounding) lead to but one conclusion—that this bond was an absolute undertaking to . . . complete the building." That this statement was not dictum appears from the fact that the Supreme Court overruled two assign-